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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE EL PASO COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether the court below erred in holding, contrary to decisions of other Circuit Courts, that a company's "tax pool analysis" is relevant under 26 U.S.C. § 7602 to an Internal Revenue Service investigation of the company's tax returns, even though the analysis was not used in preparing the returns, consists exclusively of speculation and opinion concerning potential tax issues, negotiations, and litigation the company may face, and was developed for purposes of assessing and reporting the company's contingent tax liability as required by the securities laws.

2. Whether the court below erred in holding, contrary to decisions in other Circuit Courts, that a company's tax pool analysis and its discussions relating thereto are not privileged, under either the attorney-client privilege or the work-product doctrine, even though the analysis was prepared by and in consultation with the company's attorneys and was confidentially discussed with its independent auditors for purposes of complying with the securities laws.

PARTIES TO THE PROCEEDINGS *

The parties before the United States Court of Appeals for the Fifth Circuit were the United States of America and Revenue Agents Clarence H. Isbel and John S. Reid of the Internal Revenue Service, Petitioners-Appellees, and The El Paso Company, Respondent-Appellant.

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* Petitioner, The El Paso Company, reports, pursuant to Rule 28.1 of the Rules of this Court, that it is a parent company and that its subsidiaries (except wholly owned subsidiaries) and affiliates are as follows:

El Paso Natural Gas Company
Geonuclear Nobel Paso
Minera San Pedro Corralitos, S.A.
Windjammer, Inc.

The following companies are owned by a partnership which consists of Desert American Agency, Inc. (a wholly-owned subsidiary of the El Paso group) and Hartford Insurance Company:

A.I.A. Corporation
Desert American Insurance Agency-Colorado, Ltd.
(owned 50% by the partnership)
Desert American Insurance Agency, Inc.-Arizona
Desert American Insurance Agency, Inc.-California
Desert American Insurance Agency, Inc.-New Mexico
Desert American Insurance Agency, Inc.-Virginia
(owned 50% by the partnership)

The following are joint ventures in which the El Paso group owns an interest:

Lake Country
Adams Canyon Ranch
Santa Paula Farms
La Salle Terminal Company
Dart-El Paso Polyolefins-El Paso Products

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OPINIONS BELOW

The majority and dissenting opinions of the Court of Appeals (App. 1a-42a) are reported at 682 F.2d 530. The judgment of the Court of Appeals (App. 59a-60a), entered September 30, 1982, affirming the judgment of the District Court, is unreported. The opinion of the District Court (App. 43a-58a) is unreported. The judgment of the District Court (App. 63a-65a), entered November 30, 1981, ordering compliance with the Internal Revenue Service summonses, is unreported.

JURISDICTION

The judgment of the Court of Appeals was entered on September 30, 1982. The Petition for Rehearing and Suggestion for Rehearing En Banc, both timely filed, were denied on September 18, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

26 U.S.C. § 7602

> For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary is authorized—
>
> (1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;
>
> (2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and
>
> (3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

STATEMENT OF THE CASE

On February 13, 1980, the Internal Revenue Service ("IRS") issued a summons pursuant to 26 U.S.C. § 7602 to The El Paso Company ("El Paso" or "the Company") in connection with a routine examination of the Company's tax returns for the years 1976 through 1978.[1] The summons directed El Paso to produce:

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[1] A second summons sought "[a]ll internal audit reports, including all related workpapers and logs of such reports," for the same period. Since El Paso complied with this summons, it is not before the Court for consideration. App. 8a n.1.

> Any document, memorandum, letter or workpapers which identify potential tax liabilities or tax problems for the period beginning January 1, 1976, and ending December 31, 1978, inclusive. [App. 66a.]

El Paso appeared at the time stated in the summons, but declined to comply, producing instead a letter stating its reasons for believing compliance was not required. App. 68a-71a.[2] The principal reasons stated therein that are germane to this Petition were that the documents sought were not relevant or material to any legitimate IRS inquiry, and that the documents were in any event privileged. Before describing the lower courts' treatment of these questions, and thereafter the reasons why we believe this Court should now consider those questions, it will be helpful if we first describe the documents at issue.

The Tax Pool Analysis

Each year at the direction of and in consultation with their in-house legal counsel, El Paso tax compliance personnel prepare an analysis of the Company's future potential tax liability. TR., Vol. II, at 33-35. In summary, this analysis—the "tax pool analysis"[3]—reflects the Company's best estimate of what the tax liability for that particular year will be after all potential or pending tax audits, refund claims, negotiations, and litigation are finally settled or concluded.[4] TR., Vol. II, at 33. More spe-

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[2] El Paso acted in good faith. As of August 1981 it had complied with, or was in the process of complying with, over 98 percent of some 578 Information Document Requests. Transcript of Summons Enforcement Hearing before the United States District Court for the Southern District of Texas, Vol. II, at 80-82 (hereinafter cited as "TR.").

[3] The term "tax pool analysis" is generally regarded as synonymous with the terms "tax accrual workpapers" and "contingent tax liability workpapers." *See* I Internal Revenue Manual (Audit) (CCH) § 4024.2(3) (1981).

[4] *See also* I Internal Revenue Manual (Audit) (CCH) § 232.8(4) (1981) (recognizing that such an analysis is based upon opinions

cifically, development of the tax pool analysis serves to: (1) identify issues on the Company's federal tax returns which counsel and other tax compliance personnel think could be subject to challenge in the course of an audit because of differences with the IRS on interpretation of law or characterization of fact; (2) speculate on the likelihood that the IRS will raise these issues; (3) evaluate whether the Company would litigate the issues raised and estimate its chances of prevailing; (4) review and evaluate the legal implications of the issues identified; (5) estimate the dollar amounts for which the Company would be willing to settle each controversy administratively if it chose not to litigate; and (6) assign a total estimated dollar amount to the aggregate outcome as to all issues discussed. *See* TR., Vol. II, at 33-36, 89-94, 139-40.

As expressly recognized by the lower court, the described tax pool analysis is not used in any way to assist in preparation of the Company's tax returns. App. 6a. Instead, as will be explained, the analysis is prepared to assist the Company to meet its responsibilities under the federal securities laws.

The Securities and Exchange Commission ("SEC") requires public corporations subject to the securities laws to file audited financial statements periodically. *E.g.*, 15 U.S.C. § 78*l*. These financial statements must be prepared in accordance with generally accepted accounting principles which, in turn, require disclosure of any material contingent liabilities.[5] Since income tax liability is crucial to any determination of net income, the possibility of additional tax assessments commonly constitutes a material contingent liability. Hence, the inde-

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and projections of the company conveyed in confidence to an independent accountant for the purpose of developing a worst-case estimate of contingent tax liability).

[5] Regulation S-X, 17 C.F.R. §§ 210 *et seq.* (1981); American Institute of Certified Public Accountants, Statement on Auditing Standards No. 1, § 110.01 (1973); Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 5 (1975).

pendent auditor who verifies a given company's financial statements must independently consider issues contained in the company's tax pool analysis—or prepare such an analysis itself if the company has not—and reach its own judgment concerning both the amount of contingent tax liability and any need for disclosure thereof in the financial statement.

As described later, any discussions of the tax pool analysis between a company and its auditors, or any documents furnished by either party in connection with the analysis, are treated by both parties as strictly confidential. In El Paso's case, while the auditor discussed with the Company certain items contained in the tax pool analysis, the auditor did not see any of the actual tax pool analysis documents. TR., Vol. II, at 131.

It is the above described documents (among others) which the IRS sought in the courts below.

The Lower Court Proceedings

On May 27, 1981, the IRS filed a petition for enforcement of its summons in the United States District Court for the Southern District of Texas pursuant to 26 U.S.C. § 7604. In response, El Paso contended that the summons was overbroad, that the documents sought were not "relevant" to any legitimate investigatory purpose within the meaning of 26 U.S.C. § 7602, and that the documents were protected by the attorney-client and work-product privileges. The District Court decided against El Paso as to each of these contentions, adopting without change the findings of fact and conclusions of law prepared by the Government. App. 43a-58a.

Since the District Court found, first, that the summons was not overbroad (App. 54a-55a), it also rejected El Paso's contention that the overbreadth effectively prevented the Company from making a particularized showing regarding which specific documents within the summons were privileged. App. 56a. This led the court to find, second, that El Paso had therefore waived "what-

ever privilege might have existed with respect to each document which is within the scope of the summons." App. 57a. The court found, moreover, that since the "substance" of the documents within the summons was either discussed with El Paso's independent auditors "or would have been discussed had the issue been raised," "[t]his refutes the confidentiality aspect of the attorney-client privilege." App. 57a.

Finally, the court rejected El Paso's contention (and the authorities supporting that contention) that the IRS is not entitled to require production of documents which are not either related to, used, or relied upon in the preparation of the taxpayer's return. Instead, the District Court concluded that the summoned documents should be produced since any burden on the Company was outweighed by the benefit to the IRS, the production was consistent with "our voluntary system of tax collection," and the IRS should be given at least the same access to the documents which the independent auditors had been given, in order to "protect the fisc." App. 54a.

On August 13, 1982, a divided Court of Appeals affirmed the District Court, although narrowing its judgment. Thus, the Court of Appeals, first, agreed with El Paso that the scope of the summons was not entirely clear; the court therefore narrowed the summons' reach to cover only the tax pool analysis and any memoranda used to prepare that analysis. App. 10a. Second, while acknowledging that the Tenth Circuit had decided to the contrary in *United States* v. *Coopers & Lybrand*, 550 F.2d 615 (1977), the court below held that the tax pool analysis was "relevant" to the IRS investigation of El Paso's tax returns. App. 10a-12a. Although conceding that there was *no* suspicion of fraud in this case, and that the IRS audit was entirely routine, undertaken because of the amount of money involved (App. 2a),[6] the majority nev-

[6] The dissenter pointed out that not even negligence was alleged by the IRS, and the Service was not seeking "to determine or dis-

ertheless concluded that the IRS was entitled to the tax pool analysis because it "may be useful to the IRS as a 'roadmap' through [the] company's tax return." App. 28a.

Finally, the court refused to find that the tax pool analysis was privileged, under either the attorney-client privilege or the work-product doctrine, even though the court acknowledged (App. 19a & n.13) that this result was incompatible with the recent decision of the Second Circuit in *United States* v. *Arthur Young & Co.*, 677 F.2d 211 (1982), *petition for cert. filed*, No. 82-687. (Oct. 20, 1982). The court specifically concluded that El Paso had waived the attorney-client privilege by discussing certain issues in the tax pool analysis with its independent auditor (App. 16a-20a), had failed to particularize sufficiently the specific items as to which it was claiming the privilege (App. 20a-21a),[7] and that the Company could not claim

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cover any information respecting the actual receipts, disbursements or transactions engaged in by El Paso, the accuracy and completeness of its records, or any other *factual* information respecting El Paso's tax liability or the correctness of its return." App. 29a; (emphasis in original) (footnote omitted). The majority in no way disputed these assertions.

[7] The Court of Appeals' faulting of El Paso's supposed failure to particularize is both incorrect and self-contradictory. It is clear that El Paso asserted the privilege with particularity from the outset as to the ledger sheets which compose the actual tax pool analysis. It is also clear that El Paso was unable to assert the privilege with specificity as to the other documents sought because the Government's summons did not identify the documents it sought with sufficient particularity. Moreover, an affidavit filed by El Paso's Vice President for Tax in this case reveals that the Company would have an impossible task in attempting to specify each document called for by the summons. Affidavit of Jack D. McCarthy, filed with Answer of Respondent (July 15, 1981). Finally, although the Court of Appeals expressly agreed that the application of the summons had to be narrowed to apply only to the tax pool analysis and any documents used to prepare that analysis, it nevertheless criticized El Paso for failing to make a particularity showing at a time when

the work-product privilege because the tax pool analysis was not prepared in anticipation of litigation. App. 21a-25a.

In his dissent, Judge Garwood agreed with the majority's narrowing of the summons' scope, but he expressly disagreed as to two of the questions now before this Court: whether the IRS demand was relevant under 26 U.S.C. § 7602 so as to compel production of the tax pool analysis, and whether El Paso's discussion of some of the materials in the analysis with its independent auditor waived the Company's attorney-client privilege as to all materials in the analysis. With regard to the statutory issue, Judge Garwood agreed with the Tenth Circuit's decision in *Coopers & Lybrand*, *supra*, and therefore concluded that the tax pool analysis was not "relevant" to the investigation of El Paso's tax returns. App. 29a-37a. With regard to the attorney-client privilege, Judge Garwood concluded that the majority's holding—that the mere discussion of *any* tax-pool-analysis matters with the independent auditors worked a waiver of the privilege—was so broad as to undermine the privilege and this Court's decision in *Upjohn Co. v. United States*, 449 U.S. 383 (1981). App. 40a. For these reasons, Judge Garwood would have reversed the District Court's decision and precluded enforcement of the summons. App. 37a, 41a.

El Paso's timely Petition for Rehearing of the majority's decision was denied on September 15, 1982. El Paso and the IRS have agreed to a stay of the judgment pending final disposition of this Petition.

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the summons was still overboard. Affidavit of Jack D. McCarthy, filed with Answer of Respondent (July 15, 1981).

If certiorari is granted, petitioner will argue that at least where the taxpayer is a multi-national corporation with offices, employees and files located throughout the world, the IRS should itself be required to be more specific in its initial demand before the taxpayer must conduct the extraordinarily burdensome, time-consuming, and expensive search that would otherwise be necessary.

REASONS FOR GRANTING THE WRIT

Introduction

This case raises the issue of the IRS' power under 26 U.S.C. § 7602 to compel a taxpayer to disgorge its theories, opinions, arguments, speculations, and self-critical analyses regarding its contingent tax liability. Against El Paso, the IRS has claimed the power to require production not only of a step-by-step guide to the Company's legal and non-legal judgments on issues in its tax return which may conceivably be subject to challenge, but also of any documents which might reveal which issues the Company would litigate if challenged, which it would settle, and the amounts for which it would be willing to settle. IRS attempts to obtain such information from El Paso and other taxpayers have precipitated a storm of controversy, as reflected in the considerable recent legal literature on this subject[8] and, more importantly, in the

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[8] *E.g.*, Caplin, *Government Access to Independent Accountants' Tax Accrual Workpapers*, 1 Va. Tax. Rev. 57 (1981); Diss & Hanson, *Tax Contingency Audit Workpapers: Current Developments, Observations, and Proposals*, 12 The Tax Advisor 104 (1981); Buchholz, *Tax Accrual File Controversy: Legal Problems Facing the Accountant*, 40th Annual N.Y.U. Institute on Federal Taxation 37-1 (1981); Note, *A Balancing Approach to the Discoverability of Accountants' Tax Liability Workpapers Under Section 7602 of the Internal Revenue Code*, 60 Wash. U.L.Q. 185 (1982); Staltenberg & Robinson, *Enforcement of Summaries in Requesting Accountants' Workpapers*, 1982 Taxes 673; Hanson & Brown, *CPA's Workpapers: The IRS Zeros In*, 152 J. Accountancy 68 (1981); Nath, *Internal Revenue Summaries for "Sensitive" Accountants' Papers*, 34 Vand. L. Rev. 1561 (1981); Garbis & Struntz, *The Second Circuit's Arthur Young Decision: A Privilege for Tax Accrual Workpapers*, 54 J. Tax 66 (1982); Caplin, *IRS Toughens its Stance on Summoning Accountants' Tax Accrual Workpapers*, 52 J. Tax. 130 (1980); Caplin, *Should the Service be Permitted to Reach Accountants' Tax Accrual Workpapers?*, 51 J. Tax. 194 (1979); Note, *Government Access to Corporate Documents and Auditors Workpapers: Shall We Include Auditors Among the Privileged Few?* 2 J. Corp. Law 349 (1977); Note, *Constraints on the Administrative Summons Power of the Internal Revenue Service*, 63 Iowa

now seriously divided decisions of the federal Circuit Courts. This division in the Circuit Courts has, in turn, caused considerable uncertainty in the administration of the tax laws, the relationship between companies and their independent auditors, the preparation of financial reports for public distribution, and the appropriate application of the attorney-client and work-product privileges. These circumstances underlie the reasons why the present Petition should be granted.

Broadly summarized, the pertinent decisions in the Circuit Courts have analyzed the scope of the IRS summons power under 26 U.S.C. § 7602 from either or both of two standpoints: (1) whether the information sought is "relevant" to a legitimate purpose of the IRS; and (2) whether the information is privileged. As will be discussed, on the issue of relevance the Fifth Circuit's decision directly conflicts with the Tenth Circuit's decision in *Coopers & Lybrand*, and implicitly conflicts with the decision of the Eighth Circuit in *United States* v. *Matras*, 487 F.2d 1271 (1973). (The Second Circuit's decision in *Arthur Young* also conflicts with *Coopers & Lybrand*.) On the issue of work-product privilege, the Fifth Circuit's decision conflicts with the *Arthur Young* decision, which is now before the Court on a Petition for a Writ of Certiorari filed by the Solicitor General. Finally, on the issue of waiver of the attorney-client privilege, the Fifth Circuit's decision conflicts with the Second Circuit's decision in *Arthur Young*, as well as the Eighth Circuit's decision in *Diversified Industries, Inc.* v. *Meredith*, 572 F.2d 596 (1977) (en banc), the Sixth Circuit's decision in *United States* v. *Upjohn*, 600 F.2d 1223 (1979), the

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L. Rev. 526 (1977); Saltzman, *What an Accountant Can Do About the Threat of an IRS Summons to Produce His Workpapers*, 17 Tax. for Accountants 208 (1976); Weinstein, *Taxpayers' Records and Accountants' Workpapers Now More Vulnerable to IRS Summons*, 17 Tax. for Accountants 4 (1976); Diss, *The IRS and Auditors' Tax Workpapers: How Far is Too Far?* Arthur Young Journal 11 (Summer 1976).

Ninth Circuit's decision in *Weil* v. *Investment/Indicators, Research & Management*, 647 F.2d 18 (1981), and the Eighth Circuit's decision in *United States* v. *Cote*, 456 F.2d 142 (1972).

As described later, these conflicting decisions of the Circuit Courts have introduced harmful uncertainties into the relationships between independent accountants and taxpayers, between taxpayers and their counsel, and between taxpayers and the IRS, and have produced the unacceptable anomaly of the IRS summons power and taxpayer privileges varying between different circuits. We respectfully submit that guidance is needed from this Court to resolve these conflicts and to clarify the law on these important federal issues.

1. The Decision Below Directly Conflicts With Decisions in Other Circuit Courts.

The Circuit Courts are now in conflict as to all three of the significant issues that might arise when the IRS seeks to compel production of documents such as a tax pool analysis: (a) whether such documents meet the "relevance" standard of 26 U.S.C. § 7602; (b) whether such documents are protected by a work-product privilege; and (c) whether the attorney-client privilege as to such documents is waived if they are discussed with or shown to independent auditors. Each of these three conflicts is described below.

A. Relevance

In *United States* v. *Powell*, 379 U.S. 48 (1964), this Court determined that the IRS must make the following showing in order to exercise its summons power under 26 U.S.C. § 7602: "that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner's possession, * * * that the administrative steps required by the

Code have been followed * * * and that the summons be issued in good faith." 379 U.S. at 57-58. While the *Powell* formulation may have established a relevance requirement, it does not give content to that requirement, particularly in the context of this case. Numerous decisions regarding the summoning of tax pool analyses and similar taxpayer documents have attempted to supply that content, with varying and conflicting results.

The Tenth Circuit in *Coopers & Lybrand* was the first Circuit Court to address this problem in the context of a summons seeking a tax pool analysis. The court squarely held that such a tax pool analysis, which contained the private thoughts and theories of the taxpayer and its independent accountant, was not relevant to the IRS audit. Applying a balancing test, the Circuit Court, adopting the reasoning of the District Court, considered several factors in reaching its decision, including: whether the information sought consisted of opinions and theories, not facts; whether the information sought was prepared in connection with the tax return; whether the investigation was for fraud, in which case intent would be important; whether the IRS already had in its possession the basic factual material necessary to conduct the audit; whether the IRS had a realistic expectation rather than an idle hope that something might be discovered; whether the enforcement of the summons would impair the candid interchange necessary between auditor and client, thereby threatening the continued high quality of financial reporting; and whether the IRS had shown, as required by the Eighth Circuit's *Matras* decision, a specific need for the information other than its own convenience. (The adopted reasoning of the District Court appears at *United States* v. *Coopers & Lybrand*, 413 F. Supp. 942, 949-954 (D. Colo. 1975)). Observing that under the IRS' construction of relevance, *all* corporate records could be summoned *carte blanche*, the Tenth Circuit refused to enforce the summons. 550 F.2d at 621.

In *Matras*, the IRS attempted to summons the taxpayer's budget proposals for the years under examination. The budgets contained no factual material needed by the IRS to complete its examination, but would have been useful to it as a "road map" to the taxpayer's tax returns. The Eighth Circuit upheld the District Court's ruling that only records of actual transactions, not proposed budgets, are relevant to a determination of tax liability. 487 F.2d at 1275. The Circuit Court also held that the Government's underlying view of relevance was overbroad and that the term must be construed to connote more than mere convenience. Otherwise, it said, it would be hard to imagine any corporate documents that would not fall within the ambit of the term. *Id.*

The Second Circuit, on the other hand, through its opinions in *Arthur Young* and *United States* v. *Noall*, 587 F.2d 123 (1978), *cert. denied*, 441 U.S. 923 (1979), has completely rejected the Tenth Circuit's *Coopers & Lybrand* analysis and, at least implicitly, the Eighth Circuit's *Matras* analysis as well. In *Arthur Young*, the Second Circuit held that only a low threshold of relevance—that the information sought "might have thrown light upon" the correctness of the return—need be met by the IRS. 677 F.2d at 218. Under that standard, the court concluded that the tax pool analysis there at issue was relevant. However, the Second Circuit also determined, as will be explained in the next section, that even though the tax pool analysis was "relevant," it was privileged and therefore not discoverable.

The court below expressly rejected El Paso's position, which was based directly on the *Coopers & Lybrand* holding, that the documents sought by the IRS summons were not relevant to its inquiry. App. 11a. This decision therefore adds still further conflict and confusion regarding the proper standard of relevance since the result is that in

some circuits documents such as the tax pool analysis are subject to production under 26 U.S.C. § 7602 (the Fifth and the Second) and in others they are not (the Tenth and Eighth). Moreover, the conflict and confusion in this area of the law extends to the privilege question as well.

B. Work-Product Privilege

As noted above, in *Arthur Young* the Second Circuit concluded that the tax pool analysis there in question was relevant; however, the court did not end its analysis there. It held that a work-product privilege protects such analyses from a summons except where the IRS makes a sufficient showing of need to justify invading the integrity of the auditing process. 677 F.2d at 219. The Second Circuit reached this determination after balancing the Government's interest in enforcing the tax laws and collecting revenue against the public interest in ensuring fair and honest markets in securities transactions. The court determined that the factual data necessary to the IRS audit was already available to it, and that the tax accrual workpayers were no more than a "road map" that might save the IRS some time in finding the best arguments to use against the taxpayer for purposes of asserting a deficiency. It concluded that since the IRS was not attempting to prove fraud in the case, the IRS had no need to know the taxpayer's thoughts, and that giving the IRS the complete latitude it sought for the summons power would unnecessarily compromise the public interest in accurate financial reporting. *Id.* at 219-221.

The Fifth Circuit in the present case refused to apply the privilege recognized in *Arthur Young*, apparently on the ground that the privilege had been applied in *Arthur Young* only to outside accountants. App. 12a n.7. While it is true that the *Arthur Young* case involved a summons directed to the taxpayer's outside accountant, not to

the taxpayer itself, the holding in the case was premised on the importance of preserving "the integrity of the [independent] auditing process." 677 F.2d at 221. According to the Second Circuit's decision, this process depends upon "management feel[ing] free to cooperate with their auditors, and to disclose to them confidential information such as questionable positions taken on tax returns, and willingness to settle rather than litigate when these positions are challenged by the IRS." *Id.* at 219-220. Thus, the *Arthur Young* holding seeks to assure that in the preparation of the tax pool analysis and the subsequent discussion of its contents, the taxpayer and its accountant can be completely candid without fear of disclosure. Plainly, it is of no consequence to this holding whether it was the taxpayer or its accountant who actually prepared or retains the tax pool analysis. And just as plainly, the rejection of the privilege in the instant case conflicts with *Arthur Young*.

Indeed, the decision below may well completely eviscerate the Second Circuit's decision. For the IRS, frustrated by *Arthur Young* in its attempt to obtain the tax pool analysis from the independent accountant, could merely step across the street and demand it, or testimony concerning it, from the taxpayer. The IRS would thus have access to the same information sought to be protected in *Arthur Young* even though the identical policy considerations would apply. Moreover, the IRS itself has already made clear that this scenario is not simply a remote possibility. In May of 1981 it revised its audit guidelines to advise revenue agents to proceed as follows in order to gain access to tax pool analyses:

> [T]he examiner should first take all reasonable means to secure this information from the corporate officer before looking to the independent auditor to provide the information. [I Internal Revenue Manual (Audit) (CCH) § 4024.4(5) (1981).]

Accordingly, application of the decision below and the *Arthur Young* decision to essentially like circumstances will produce contradictory results. Authoritative guidance from this Court is needed to reconcile these contradictions.

C. Attorney-Client Privilege

The Fifth Circuit concluded that El Paso waived its attorney-client privilege as to all the documents and information in the tax pool analysis when it "discussed 'some of the information and many of the potential tax liability issues' in its tax pool analysis with the independent auditors who certify the corporation's books." App. 17a. The court expressly recognized, however, that this holding conflicted with *Arthur Young*, since under *Arthur Young* "the taxpayer's revelation of tax accrual workpapers to an accountant should be considered a communication in confidence." App. 19a (footnote omitted).

Furthermore, the Fifth Circuit's implicit ruling that a disclosure of information to an independent auditor pursuant to SEC requirements constitutes a waiver even though the information will not be made public is contrary to the *en banc* holding of the Eighth Circuit in *Diversified Industries, Inc.* v. *Meredith*, *supra*. The *Diversified Industries* court ruled that voluntary disclosure of documents to the SEC in a nonpublic SEC investigation constituted a waiver of the attorney-client privilege only as to the SEC. 572 F.2d at 611. Since in the present case the documents at issue were not ever disclosed to the SEC itself, but were only confidentially discussed with the Company's auditor in order to meet an SEC requirement,[9]

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[9] Moreover, as the court below recognized (App. 14a n.10), since its holding requires disclosure of the entire tax pool analysis, and any documents used to prepare the analysis, even though not all of the issues reflected in these documents were shown to have been discussed with the auditors, the holding conflicts with other Circuit Courts in this regard as well. *See United States* v. *Upjohn*, *supra*, 600 F.2d at 1227 n.12 (corporation's voluntary disclosure of

the Eighth Circuit's *Diversified Industries* holding would *a fortiori* preclude a finding of waiver.[10]

It is apparent, then, that the Fifth Circuit's decision in this case is in sharp conflict with numerous other Circuit Courts on the issues of relevance, work-product doctrine, and waiver of attorney-client privilege. The Court should review these issues in this case in order to resolve these conflicts and ensure uniform application of the law.

2. This Case Presents Important Questions of Law and Public Policy Which Should be Addressed by the Court.

El Paso's case raises important and recurring issues of law and public policy involving the tax laws, the securities laws, and the ability of legal and accounting professionals to advise their clients effectively. Specifically, the case presents three separate issues requiring that the Government's need to enforce its tax laws be balanced against another important, and conflicting, interest: first, against the public's need to ensure a full and free flow of financial information to the securities markets; second, against the public's interest in ensuring that the tax laws be *fairly* enforced, in a manner that involves no government overreaching; and, third, against the public's interest in ensuring that the tax laws are enforced in a way that does not jeopardize taxpayers' confidential relationships with their professional advisers. It is submitted

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privileged information to government agency constitutes waiver "only with respect to the facts actually disclosed"). *Accord, Weil* v. *Investment/Indicators Research & Management, supra*, 647 F.2d at 25; *United States* v. *Cote, supra*, 456 F.2d at 145 n.4.

[10] Other decisions conflicting with the *Diversified Industries* holding include the D.C. Circuit's decision in *Permian Corp.* v. *United States*, 665 F.2d 1214, 1219-22 (1981), and the Fourth Circuit's decision in *In re Weiss*, 596 F.2d 1185 (1979) (declining to apply limited waiver concept to grand jury proceedings following SEC investigation).

that the Court should grant the Petition in this case in order to review and provide guidance concerning these issues. We briefly summarize these issues below.

First, the IRS policy of issuing summonses for tax pool analyses has created a fundamental conflict between " 'the legitimate interest of society in enforcement of its laws and collection of the revenues,' *Couch* v. *United States*, 409 U.S. 322, 336 (1973), and the 'national public interest [in] insur[ing] the maintenance of fair and honest markets in [securities] transactions.' 15 U.S.C. § 78b." *Arthur Young*, 677 F.2d at 219. This conflict flows from the fact that, as pointed out above, the securities laws and regulations require public companies subject to the securities laws to file audited financial statements containing disclosure of material contingent tax liabilities. *See* 15 U.S.C. § 78*l*; 17 C.F.R. § 210.1-02(d) (1981).

The IRS policy places these public companies in a difficult dilemma. The company and its independent accountant *must* undertake a tax pool analysis if the company is to comply with SEC financial reporting requirements. Such an analysis necessitates consultation among the company employees responsible for the analysis and the independent accountant, as well as legal counsel. The more frank and candid these exchanges, the more reliable will be the assessment of contingent tax liability reported to the SEC and publicly disclosed in the company's financial statements. But at the same time, frankness and candor may well lead to vulnerability. This is because, under the ruling below, every expression of concern, every question raised, every good-faith doubt considered by the company must be disclosed and will inevitably invite and concentrate IRS scrutiny. Indeed, the company may well be met by a quotation from its own attorney or accountant if it should later challenge an IRS position or attempt a reasonable settlement of a dispute.

Moreover, the clear import of the ruling below is that the IRS is entitled not only to documents, notes, and other workpapers identifying potential "liabilities or tax problems," but also to the testimony of the attorneys and accountants who are responsible for such workpapers.[11] Testimonial evidence revealing subjective intent, opinions, and the like logically follows from the majority's reasoning because: (a) workpapers may make little or no sense without an explanation as to their meaning, and (b) if there were no privilege for documents, there would be none for testimony.

Nor will testimony be limited to the content of workpapers. Just as the summons in this case was broadly worded, so will the IRS be authorized to seek in each case the most extensive verbal "roadmap" through all of the company's transactions which could possibly affect tax liability, even if the witness is expressing pure speculation.

The company will thus be placed in a serious quandary. If its tax pool analysis is thorough, it subjects itself, its accountants, and its attorneys to unrestricted IRS inquiry and compromises its ability to defend, settle, or litigate any controversies that may arise. On the other hand, if it limits its tax pool analysis and tells its advisers as little as possible in order to shield them from inquiry, accuracy will necessarily be reduced and both the company and the public will be thereby disadvantaged. This quandary is not, as the Court of Appeals said, "wholly speculative." App. 26a-27a. On the contrary, it derives from common sense and experience and follows inexorably from the result reached below.

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[11] Thus, the summons at issue in this case ordered El Paso's principal tax counsel to appear and "give testimony" relating to the company's "tax liability or the collection of the tax liability * * *." App. 66a.

Both current IRS Commissioner Roscoe Egger and former Commissioner Mortimer Caplin have publicly recognized that this issue is of serious concern to the SEC, the accounting profession, businesses, and the public.[12] Thus, Commissioner Egger cites reports that IRS requests for tax pool analyses were "driving a wedge between CPA's and their clients" (IRS News Release, IR 81-49, *supra* note 12, at 3), cutting off the flow of tax accrual information to independent auditors, and causing concern to the SEC because of its interest in full financial disclosure. *Id.*[13] Caplin finds that "[t]he policy arguments for limiting the Service's access to accountants' tax accrual workpapers are persuasive," arguing that otherwise the quality of financial reporting will be harmed. 1 Va. Tax Rev., *supra* at 81-82. Finally, the Buchholz article cited above documents actual instances of the adverse effects of forced production of tax pool analyses on the quality of financial reporting. 40th N.Y.U. Institute on Federal Taxation, *supra* at 37-14, 37-16. *See also* Kurtz, *Discussion on "Questionable Positions,"* 32 Tax. Law. 13, 14 (1978) (remarks of former IRS Commissioner Jerome Kurtz before the May 20, 1978 meeting of the American Bar Association, Section on Taxation). We submit, therefore, that before the described balance is

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[12] IRS News Release, IR 81-49, Remarks by Roscoe L. Egger before the San Francisco Chapter of the California Institute of Certified Public Accountants and the Tax Section, San Francisco Bar Association, May 5, 1981; Caplin, *Government Access to Independent Accountants' Tax Accrual Workpapers*, *supra* 1 Va. Tax Rev. at 81-83 (1981).

[13] The IRS amended the Internal Revenue Manual on May 14, 1981 to establish a required system of administrative approval before tax pool analyses are sought from independent accountants. I Internal Revenue Manual (Audit) (CCH) ¶ 4024.4 (1981). The change appears merely to shift the burden of production from the accountant to the taxpayer. *See* Buchholz, *Tax Accrual File Controversy: Legal Problems Facing the Accountant*, 40th Annual N.Y.U. Institute on Federal Taxation 37-1, 37-14 (1981).

struck in favor of permitting the IRS unrestricted access to tax pool analyses, it is a matter of sufficient importance to warrant this Court's attention.

Second, before any such access is permitted, we believe that this Court should assess its fairness and its likely effect on our voluntary self-assessment tax system. It is clear that that system depends upon a perception by taxpayers of good faith and fairness on the part of the Government. It is also apparent that Government unfairness and overreaching created by excessive IRS demands for taxpayers' private thoughts and theories could erode the underpinnings of that voluntary system. *See* Caplin, *Government Access to Independent Accountants' Tax Accrual Workpapers*, *supra*, 1 Va. Tax. Rev. at 82 (to preserve self-assessment system, IRS must treat taxpayers in fair, evenhanded manner); Note, *A Balancing Approach to the Discoverability of Accountants' Tax Liability Workpapers Under Section 7602 of the Internal Revenue Code*, *supra*, 60 Wash. U.L.Q. at 207. IRS's authority in this regard should thus be reviewed by this Court and approved only after the necessary balancing has occurred.

Such a balancing should include, among other things, a recognition that the audit examination, negotiations, and any subsequent proceedings involve an adversary process. *See* Kurtz, *supra*, 32 Tax Law. at 25. The balancing should also assess the fairness of requiring the taxpayer in such a process to disclose its negotiating positions without placing a corresponding duty on the Government. Scrutiny of such a requirement should be particularly close in any case where the IRS has at its disposal all the facts it needs to make its determination of the amount of tax due.[14]

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[14] In the present case, the IRS identified concerns of speed and efficiency in the audit process—not unavailability of basic factual

Moreover, the balancing should take into account that requiring taxpayers to arm the IRS with arguments in order to challenge positions taken in their own returns may be a matter of such significance that no demand should be enforced on the basis of an ambiguous summons statute, but should await explicit congressional approval. This is particularly true here, where there is recent evidence that Congress would not sanction such summons authority. In § 323(a) of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248 (to be codified at 26 U.S.C. § 6661), Congress has for the first time enacted a provision which *encourages* disclosure of positions for which the taxpayer does not have substantial authority.[15] This newly enacted statute goes nowhere near as far as the IRS is attempting to go by summoning tax pool analyses, and is an indication that such summonses would not meet with approval if the question were put to Congress.

In summary, serious and far-reaching questions of fairness are presented by the broad construction of the IRS summons power approved by the court below, and those questions should be considered by this Court before that construction is followed elsewhere.

Finally, the threat to the attorney-client privilege entailed in the ruling below is so significant that the ruling

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information—as its reason for seeking the tax pool analysis. TR., Vol. I, at 34. The IRS also stated that there was no evidence of fraud for which evidence of intent might be relevant. TR., Vol. I, at 72. In addition, this case is not a situation in which the taxpayer is postulated to be taking unreasonable positions on various issues in its tax return.

[15] This new section provides a penalty for substantial underpayment of tax, but forgives the penalty on any amount of understatement for which the taxpayer has adequately disclosed the relevant facts respecting the position taken on its return. The penalty is also forgiven if the taxpayer has substantial authority for its position.

should not receive further application without this Court's review. The purpose of the attorney-client privilege, as this Court has stated, is "to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice." *Upjohn*, *supra*, 449 U.S. at 389. The court below has now held that the privilege is lost as to all information on a particular subject when any part of that subject is discussed with a taxpayer's independent auditor. It has reached this conclusion in a case where the person to whom the information was communicated is bound by professional ethics and administrative rules of all 50 states not to disclose the information related to him.[16] AICPA Code of Professional Ethics, Rule 301 ("A member shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of his client"). Moreover, the holding has occurred in a case where the client was obliged by other laws (here the securities laws) to make the disclosure.

The implications of such a holding, we submit, threaten the survival of the attorney-client privilege as designed by this Court in *Upjohn*. For the logic of the decision below, as pointed out by Judge Garwood in his dissenting opinion, is that any person who discusses any subject with his attorney forfeits all protection as to that discussion if he receives advice on the same subject from anyone else—even if the latter exchange was strictly confidential, and even if it was essential in order to comply with the law. Such a holding should not stand, much less without the review and approval of this Court.

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[16] The IRS recognizes in its Manual that the tax pool analysis consists in part of opinions and projections communicated *in confidence* to the independent accountant. I Internal Revenue Manual (Audit) (CCH) § 232.8(4) (1981).

CONCLUSION

Because of the conflict in the Circuit Courts on the issues of relevance and privilege in the enforcement of IRS summonses, and due to the importance of encouraging accurate financial reporting, promoting taxpayer faith in the fairness of the voluntary self-assessment system, and safeguarding the attorney-client privilege, it is submitted that the Court should review this case and provide the needed guidance to the lower courts on these recurring questions. We therefore respectfully urge the Court, for all the reasons stated, to grant a writ of certiorari and reverse the decision below.

Respectfully submitted,

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